Franchise Tax Board ANALYSIS OF ORIGINAL BILL							
Author: Cogdill & Garcia		Analyst:	Kristina E. No	orth Bill Number	: AB 63		
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	December 5, 2002		
		Attorney:	Patrick Kusial	K Sponsor:			
SUBJECT:	Irrigation System Im	nprovement C	osts Credit				
SUMMARY							
This bill would create a tax credit for the cost of farm irrigation system improvements used to conserve water.							
PURPOSE OF THE BILL							
According to the author's staff, this bill is intended to reward agricultural businesses for being good stewards of the land entrusted to them.							
EFFECTIVE/OPERATIVE DATE							
As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2003, and before January 1, 2008.							
POSITION							
Pending.							
ANALYSIS							
FEDERAL/ST	ATE LAW						
Existing state and federal laws allow taxpayers to use various credits against tax. Neither state nor federal laws currently have a tax credit similar to the one proposed by this bill.							
Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in the production of income or property used in a trade or business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land. Significant improvements to property are added to the basis of the property and are depreciated over the property's remaining useful life.							
Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. Expenses related to water conservation qualify to be depreciated to the extent that they are ordinary and necessary business expenses and are not for the purchase of property with a useful life of more than one year.							
Board Position: S S N	A NA O O OUA		NP NAR PENDING	Department Director	Date		

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THIS BILL

This bill would allow a taxpayer that owns or leases land to claim a tax credit equal to 25% of the costs of purchasing and installing an irrigation system improvement, not to exceed \$150 per acre (or portion thereof). The system must be used in a business for the production of farm income and result in water conservation or savings.

This bill would extensively define the term "irrigation system improvement" in terms of the types of qualifying equipment, and the impact on water use. An irrigation system improvement also would be defined to include a physical improvement, an alteration of real property, or an installation of equipment certified to meet the bill's criteria.

A registered civil engineer or certified irrigation designer must certify all irrigation system improvements. The registered civil engineer or certified irrigation designer must be independent of the taxpayer, and the seller or provider of the physical improvement, alteration, or equipment. Certification would be required no later than the close of the taxable year in which the irrigation system improvement was placed in service.

The basis of the irrigation system improvement would be reduced by the amount of the allowable credit.

This bill would allow the taxpayer to carryover the credit for seven taxable years.

This bill would require the taxpayer to recapture the credit allowed if certain events occur within one year of the date the irrigation system is first placed in service. These events would include the sale of the irrigation system improvement, removal of the system from the state, disposal of the system to an unrelated party, cessation of use for the production of farm income, or termination of the lease of the land where the system is installed by the taxpayer.

This bill would require an annual report to the Legislature by the department regarding the utilization of the credit.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would occur during the department's normal annual update.

LEGISLATIVE HISTORY

AB 2570 (Cogdill; 2001/2002) would have allowed a 25% credit for the cost of farm irrigation system improvements and require FTB to report annually to the Legislature on the use of the credit. This bill was held in the Assembly Revenue and Taxation Committee.

SB 435 (Monteith; 2001/2002) would have allowed a 30% credit for the cost of farm irrigation system improvements and allowed an election to deduct the costs of a water filter system. This bill was held in the Senate Revenue and Taxation Committee.

AB 1054 (Cogdill; 2001/2002) would have allowed a 25% credit for the cost of farm irrigation system improvements. This bill was held in the Assembly Revenue and Taxation Committee.

SB 1974 (Poochigian; 1999/2000) would have allowed an unspecified credit for the cost of a water filter system. This bill was held in the Senate Revenue and Taxation Committee.

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PROGRAM BACKGROUND

A similar tax credit for the purchase and installation of water irrigation systems expired on December 31, 1985. That credit, taken in the year of installation, was equal to the lesser of 10% of the cost or a maximum of \$500 and was in addition to any other qualified deductions.

OTHER STATES' INFORMATION

A review of *Florida, Illinois, New York, Massachusetts, Michigan,* and *Minnesota* tax laws found no comparable tax credit or ordinary deduction. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue analysis is estimated to impact income tax revenue as shown in the following:

Revenue Impact of AB 63						
Tax Years Beginning On or After January 1, 2003						
Enactment Assumed After June 30, 2003						
\$ Millions						
	2003/04	2004/05	2005/06			
Revenue Impact	-17	-21	-24			

Any changes in employment, personal income, or gross state product that could result from this measure are not considered.

Revenue Discussion

This bill is nearly identical to AB 2570 as amended April 27, 2002. The tax credit estimate can be summarized as follows for the first fiscal year: Total eligible costs (\$128\$ million) \times 25% credit \times portion used (50%) = \$16\$ million.

For the irrigation system improvement costs, the estimate was developed in several steps. Discussions with industry experts indicate that replacing existing irrigation systems would induce the adoption of water-saving systems or equipment for approximately 200,000 acres annually (about 199,000 in 2003) of irrigated California land. The average cost per acre to install the equipment and improve the irrigation system was projected to be about \$640 per acre for 2003. This figure was adjusted for inflation for subsequent years.

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For 2003, the impact for 199,000 acres would be \$16 million, increased to a \$17 million loss for the 2003/2004 fiscal year due to the recent suspension of NOL deductions which, for some taxpayers, increased the amount of credits that could be used. $(199,000 \times $640 \times 25\%)$ credit x 50% usage = \$16 million) The portion of credits that could be applied in any given year against available tax liabilities was estimated using tax returns that report farm income. It was assumed that unapplied carryover credits would be exhausted by the fourth year.

POLICY CONCERNS

This new credit would require an adjustment to reduce basis in order to eliminate the double benefit of receiving both the credit and the expense deduction or depreciation deduction. However, this adjustment would create a state and federal difference, which is contrary to the state's general federal conformity policy.

LEGISLATIVE STAFF CONTACT

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